applicant may abuse its market power in this way requires a detailed examination of market conditions in the foreign country.[24] Further, the scope of such an examination may exceed the possession of any "unique combined resources" (NPRM ¶ 40) that may allow a carrier with foreign market power to harm competition. USTR states (*id.*): "For example, the ability to distort competition may result from the absence of a transparent regulatory framework in the foreign market, the failure of foreign regulations to protect competition, the lack of enforcement of existing regulations or problems with interconnection for the provision of international services." USTR's comments demonstrate that the assertions by GTE (pp. 4, 11) and Telefonica (p. 5, n.11) that the GATS precludes any review of home market conditions are not correct.

The factors cited by USTR are not exclusive, and include three key requirements of the ECO test. As the Commission has previous established, the elements of the ECO test provide the level of market openness that is necessary to preclude the leveraging of foreign market power.[25] Accordingly, the Commission should continue to conduct this pre-entry inquiry to determine whether a carrier with foreign market power would be able to leverage its market power to distort U.S. competition. *See* AT&T at 18.

The ECO test should, however, be modified for future use. *Id.*

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[24] As Sprint observes (p. 6), "the openness of [] foreign markets should be deemed relevant only insofar as it affects competition in the U.S. domestic or international telecommunications markets." Sprint nonetheless mistakenly contends (p. 8) that the WTO agreement precludes any denial of applications from WTO member countries. As USTR affirms, the U.S. may do so on public interest grounds, including the prevention of competitive harm.

[25] *See, e.g., Foreign Carrier Entry Order*, 11 FCC Rcd. at 3912.

Henceforth, it should focus upon the extent to which the ability of the applicant to abuse its market power is limited by effective competition, and upon the implementation of WTO commitments, rather than upon the existence of market opportunities for U.S. carriers. Thus, the present requirements of the ECO test should be modified to examine whether the relevant country has implemented WTO commitments (1) to provide unrestricted market access for the provision of the relevant service, (2) to allow the foreign ownership of controlling interests in carriers providing the relevant service, and (3) to meet the requirements of the GATS Reference Paper.[26] *Id.*

As USTR affirms, such an examination of foreign market conditions is both necessary to ensure that applicants with foreign market power may not distort competition to the disadvantage of U.S. consumers and entirely consistent with U.S. commitments under the WTO agreement. Accordingly, WTO requirements present no impediment to the continuation of the Commission's present pre-entry analysis, modified to focus on the market power of the applicant.[27]

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26 In addition, to ensure consistency with GATS national treatment requirements, the Commission should apply these requirements to U.S. carriers with foreign market power. *See* AT&T at 18. n.28. But contrary to DT's claim (pp. 10-11), these requirements should not be applied to dominant U.S. carriers "regardless whether such carriers have market power at the foreign end" or "even where they have no foreign affiliations." Just as foreign carriers are not subject to pre-entry analysis on non-affiliated international routes, or on affiliated routes on which they have no market power at the foreign end, so should U.S. carriers not be subject to such analysis in such circumstances.

27 The continuation of existing entry rules is required for carriers from non-WTO Member countries, irrespective of the future treatment of carriers from WTO Member countries. *See also,* BTNA at 6; WorldCom at 8-9. Neither the NPRM nor any commenter contends that the WTO agreement will do anything to open the markets

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2. The WTO Agreement Does Not Require a "Very High Risk to Competition" Threshold of Harm or Presumptions in Favor of Entry and Flexibility.

AT&T has further demonstrated (p. 20-21) that the adoption of the proposed threshold requirement for a showing of "a very high risk to competition" to warrant the denial of a license is not necessary under the GATS. Specifically, the retention of the existing "substantial harm" standard would be fully compatible with GATS Article VI requirements that regulations be "administered in a reasonable, objective and impartial manner,"[28] would be equally "based on objective and transparent criteria," and would be no more burdensome than necessary. Similarly, neutral presumptions for entry and flexibility, rather than the rebuttable presumptions proposed by the NPRM, would be equally consistent with these GATS requirements.[29] The comments make no showing to

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of non-WTO countries or to remove the ability of carriers from such countries to leverage market power. The fact that, under the Commission's proposal, carriers from WTO Member countries that may be less competitive than non-WTO Member countries would now obtain entry to the U.S. is not grounds for removing the ECO test altogether, as Sprint suggests (p. 6), but rather indicates that this entry standard should be retained for all countries to prevent competitive harm to the U.S. market.

[28] DT's claim (p. 11) that "very high risk" standard requires "objective content" reflects a fundamental misunderstanding of Article VI. This Article of GATS does not prohibit all regulatory standards that involve any element of judgment or discretion, but rather requires that the standard must be neutral as regards all parties and applied in an objective manner. In fact, Section 4(a) of Article VI uses "competence" as an example of standards that qualify as "objective" -- a standard that must require the exercise of judgment by the regulator. A standard of "harm to competition" is certainly no less objective. As long as this standard is applied equally to all entities, it does not contravene GATS.

[29] *See also*, WorldCom at 3-8 (urging retention of the Commission's existing public interest standard, rather than the proposed presumption in favor of entry, and the continued use of the "substantial harm to competition" standard for competitive harm).

the contrary.[30]

There is certainly no basis for BTNA's proposed extension of the presumption (pp. 2-3) in favor of entry to include the assumption that applicants will implement WTO commitments on a timely basis and will not engage in anticompetitive behavior. The 1971 *Specialized Common Carrier Decision*[31] that BTNA proffers as authority for its proposed blanket public interest finding in favor of foreign carrier entry is totally inapposite. That decision authorized service by new entrant private line carriers -- none of which had any market power -- in competition with the then-monopoly AT&T. Here, the Commission would be authorizing entry by carriers with market power -- and, in many cases, monopoly power -- into the highly competitive U.S. international market.[32] Moreover, the Commission has recently concluded that U.S. consumers "do not receive the maximum benefits of reduced rates, increased quality, and innovation" where a foreign carrier provides U.S.-outbound services on routes on which it has bottleneck control at

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30 FT fails to explain (p. 19) why a presumption in favor of flexibility would be "appropriate" in light of the WTO agreement. As AT&T has described (pp. 22-24), U.S. practice regarding the injury test in antidumping investigations shows that a neutral burden of proof, with the regulator required to make a positive finding on the basis of all the available facts, is equally consistent with WTO requirements.

31 *See Establishment of Policies and Procedures for Consideration of Application to provide Specialized Common Carrier Services in the Domestic Public Point-to-Point Microwave Radio Service and Proposed Amendments to Parts 21, 43 and 61 of the Commission's Rules*, 29 F.C.C. 2d 870 (1971) ("*Specialized Common Carrier Decision*").

32 *See Motion of AT&T to be Declared Non-Dominant for International Service*, FCC 96-209, Order (released May 14, 1996), at ¶¶ 37, 42-63 (elasticities of demand and supply in the market for U.S. international services are high, and AT&T, the largest carrier, has suffered a rapid decline in market share).

the foreign end.[33]

III. UNLESS SETTLEMENT RATES ARE REDUCED TO COST-BASED LEVELS, LICENSE DENIALS WILL BE NECESSARY TO PREVENT COMPETITIVE HARM FROM THE LEVERAGING OF FOREIGN MARKET POWER AND ONE-WAY SETTLEMENTS BY-PASS.

Requiring settlement rates to be at the upper-end of the benchmark ranges, as provided by the new safeguards adopted by the Commission in the International Settlement Rate Benchmark proceeding,[34] will not prevent competitive harm to the U.S. market from the provision of switched services on affiliated routes. *See* AT&T at 24-43. Those commenters that attempt to deny the validity of this concern fail to take account of the additional settlements revenues that may be obtained by using above-cost settlement rates to price-squeeze unaffiliated U.S. carriers and to by-pass settlements on U.S.-in-bound calls.

As MCI concurs (p. 3), only if settlement rates are required to be at the low-end of the benchmark ranges -- as a reasonable proxy for cost-based levels -- can the likelihood of competitive harm be significantly reduced unless there is an open market at the foreign end of the international route. Such a condition would preclude the leveraging of above-cost settlement rates and would be consistent with U.S. obligations under the WTO agreement. Its adoption would both prevent competitive distortion and promote

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33 *Foreign Carrier Entry Order*, 11 FCC Rcd. at 3880 (emphasis added).

34 *See* "Commission Adopts International Settlement Rate Benchmarks," IB Docket No. 96-261, Report No. IN 97-24, Aug. 7, 1997 ("*International Settlement Rate Benchmark News Release*"). The Commission's *Report and Order* in the *International Settlement Rate* proceeding is not yet available.

efficient entry. Unless such rates are required, license denials will be necessary to prevent competitive harm from above-cost settlement rates.[35]

1. Cost-Based Settlement Rates Are Necessary to Prevent Carriers Providing U.S.-Outbound Facilities-Based and Switched Resale services on Affiliate Routes From Engaging in Price Squeezes of Unaffiliated Carriers.

AT&T has shown in its comments (pp. 24-33) and in the affidavit of Dr. William H. Lehr ("Lehr Aff.") attached thereto[36] that by using a U.S. affiliate to provide facilities-based or resold U.S.-outbound services, foreign carriers may use even high-end benchmark settlement rates to price squeeze unaffiliated U.S. carriers. Foreign carriers could undertake such conduct motivated by a desire to subsidize entry into U.S. markets, to raise rivals' costs, and to generate additional settlement subsidies. "The smaller the [U.S.] market share of the foreign subsidiary and the more elastic is demand, the greater the foreign carrier's incentive to engage in this strategy." Lehr Aff. at 18.

AT&T's comments and the affidavit of Dr. Lehr demonstrate the falsity of the contentions by C&W (p. 6) and Telefonica (pp. 7-9) that foreign carriers would not

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[35] The post-entry conditions adopted in the *International Settlement Rate* proceeding do not preclude the adoption of such further conditions as the Commission may find necessary to prevent competitive harm to the U.S. market on the basis of the record developed in this proceeding.

[36] The memorandum by Dr. Lehr attached hereto as Attachment 2 ("Lehr. Mem.") provides further explanation of the underlying assumptions made in the affidavit.

profit by using their above-cost settlement rates to force losses on unaffiliated U.S. carriers in this way. Telefonica's attempted demonstration (*id.*) that U.S. market entry by foreign carrier leads to lower, not higher, settlements revenues takes no account of the additional settlement revenues to be obtained by reducing price in the U.S. *See* Lehr Aff. 13-15. Lower prices would be matched by unaffiliated U.S. carriers, stimulating additional outbound traffic and increased settlement payments -- and thus producing an overall net gain for the foreign carrier. *Id.* While the foreign carrier's U.S. affiliate would incur only a small part of the loss imposed on U.S. industry, the foreign carrier would receive all the additional settlements payments resulting from the stimulated U.S.-outbound traffic. Such a strategy would be eminently rational for the foreign carrier, but would cause severe harm to U.S. industry and to consumers. *See* AT&T at 26.

Equally misguided is Telefonica's statement (p. 10) that foreign carriers cannot price squeeze their competitors because they do not control U.S. carriers' input prices. As Dr. Lehr notes, this contention is "correct, but irrelevant: no one disputes that present settlement rates are significantly above economic costs." Lehr Aff. at 22.[37] Telefonica also makes the false assumption (p. 10) that the foreign carrier would seek only to "drive AT&T and other U.S. competitors out of a particular market." However, "[g]enerating additional settlement profits and/or hindering increased competition in the foreign market (e.g., by increasing rivals' costs) are even more likely motivations." Lehr Aff. at 23. In fact, the International Bureau has recently concluded that a foreign carrier

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[37] *See also,* Lehr. Mem. at 1, n.1 ("While the foreign carrier may not be able to increase settlement rates, the foreign carrier can prevent settlement rates from decreasing.").

may seek to use its above-cost settlement rate "to price squeeze other carriers" on an affiliated route "to generate significant settlement payments to its foreign carrier affiliate."[38]

Moreover, the attractiveness of such a price squeeze strategy for foreign carriers is unaffected by the mode of entry. Equivalent profits may be obtained from a resale price squeeze as from a facilities squeeze. Resale entry even has significant advantages over facilities-based entry. It is less expensive and less capital intensive, and can occur more rapidly. Entry though resale is particularly advantageous under the Commission's proposal <u>not</u> to require settlement rates to be reduced even to high-end benchmark levels for resale entry -- unlike the Commission's requirement for settlement rates to be reduced to these levels for facilities-based entry. Indeed, "the higher the settlement rate, the more attractive the [price squeeze] strategy." Lehr Aff. at 17.

Because settlement rates, even at upper-end benchmark levels, exceed cost by much greater sums than U.S. domestic access charges, foreign carriers have an even greater ability to price squeeze their competitors than the U.S. domestic local exchange carriers that are acknowledged by the Commission to have the ability to engage in such conduct when they offer in-region long-distance services. *See* AT&T at 27-28. Moreover, the Department of Justice has found not only that foreign carriers could behave

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[38] *Telstra, Inc.*, ITC-96-321, Order and Authorization (released Nov. 19, 1996), ¶ 11. *See also, GTE Telecom Inc.*, ITC-95-443, Order, Authorization and Certificate (released Sept. 16, 1996) ("*GTE Order*"), ¶ 45 (finding that "AT&T has raised a plausible scenario under which GTE could maximize its overall profits by pricing GTE Telecom's U.S. resold switched services at or even below cost in order to generate significant settlement payments to its foreign carrier affiliates").

in this way once they enter the U.S. market but that such conduct could result in substantial competitive harm. *Id.* at 27.

Retention of the 14-day filing period for tariffs, as advocated by PanAmSat (pp. 3-4), would not remove the potential for harm. This period would not allow adequate review, there would be no requirement for cost support for tariffs, and the cause of the problem, the above-cost settlement rate, would remain in place. The most effective remedy would be to require cost-based settlement rates, which would "result in a real gain to consumers and would improve, rather than harm the competitive process in the U.S." Lehr Aff. at 16.

2. Cost-Based Settlement Rates Are Necessary to Prevent Carriers Providing Inbound Switched Services Over International Private Lines from Engaging in One-Way By-Pass.

As AT&T has shown (p. 10 & Attachment 2), the WTO agreement would not provide sufficient market-opening opportunities to prevent competitive harm to the U.S. market from one-way by-pass if the Commission removes the existing equivalency requirement. Contrary to the claims by Frontier (p. 2-3) and Viatel (p. 6) that the WTO agreement will have that result, only 25 countries have made WTO commitments allowing the termination of inbound switched traffic into their markets over international private lines on January 1, 1998 and meeting the additional requirements of the equivalency test. *See* AT&T at Attachment 2. It cannot therefore be concluded that the WTO agreement renders one-way by-pass "a small and relatively short-term concern," as Frontier contends (p. 3).[39]

To the contrary, because other countries' WTO commitments do not provide sufficient outbound by-pass opportunities for U.S. carriers, the requirement adopted in the *International Settlement Rate* proceeding for settlement rates to be reduced to high-end benchmark levels on an international route will not prevent competitive harm from the provision of switched services over international private lines. *See* AT&T at 33-43. First, while this new safeguard requires "half the traffic on the route in question" to be settled "at or below the benchmark rate,"[40] it is as yet unclear whether the benchmark settlement rate must at least be available to all U.S. carriers, which should also be required.[41] Second, the substantial margins between U.S. cost-based termination rates and the high-end benchmark settlement rates of 15 - 23 cents would still provide a significant

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39 There is also no basis to Viatel's claim (pp. 5-6) that one-way by-pass is a "speculative" concern. These services have not been "widely available for some time" but are limited to the four countries (Canada, the UK, Sweden and New Zealand) the Commission has found to meet equivalency requirements. *See* AT&T at 40, n.72. Moreover, unlawful by-pass activities have been the subject of complaint to the Commission. *See American Telephone & Telegraph Co. v. Swiftcall Ltd.*, (filed Oct. 28, 1993) (Informal Complaint) (alleging that as a result of Swiftcall's unlawful resale of switched services from the UK to the U.S. "AT&T has been deprived of its proportionate share of inbound settlement minutes from the United Kingdom, and has made settlements payments to the telephone administrations in these countries that were larger than they would have been but for the acts of the defendant.") Furthermore, the Commission's existing requirement for semi-annual reports on ISR traffic, which Viatel contends would allow the detection of anticompetitive conduct, has been widely ignored. *See* AT&T at 39, n.68.

40 *International Settlement Rate Benchmark News Release* at 3.

41 As noted above, the Report and Order in the *International Settlement Rate* proceeding is not yet available.

incentive for the inbound by-pass of settlement rates that the Commission has repeatedly found to be a potential cause of severe competitive harm to the U.S. *Id.* at 33-34.[42]

As the Department of Justice has found, if a foreign dominant carrier is able to divert its U.S.-inbound traffic to an international private line arrangement with a U.S. affiliate, "[s]uch conduct could raise prices to U.S. consumers or otherwise harm competition in the United States" unless unaffiliated U.S. carriers are able to divert their U.S.-outbound services to similar arrangements.[43] Through such conduct, a foreign carrier may raise its rivals' costs to limit competition in the U.S. or in the foreign market, and increase settlement rate subsidies to fund other anticompetitive activities.

As AT&T (p. 41) and MCI (p. 3) conclude, settlement rates on the relevant international route should be available to all U.S. carriers at the low end of the benchmark range to prevent such harm.[44] As Viatel notes (p. 8), the settlement rate safeguard should

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[42] Frontier's claim (p. 4) that the equivalency test should be removed for both WTO and non-WTO Member countries to encourage lower settlement rates ignores the Commission's repeated findings that such action would lead to one-way by-pass and exacerbate the U.S. settlements imbalance. Nothing in the NPRM or put forward by any commenter shows that such concerns no longer apply to non-WTO Member countries.

[43] *See U.S. v. MCI Communications Corp. & BT Forty-Eight Co.*, 59 Fed. Reg. 33015, 33020 (Competitive Impact Statement); AT&T at 35 & n.63.

[44] As Sprint observes (p. 14), "By requiring the use by U.S. carriers of accounting and settlement rates closely related to costs, the Commission will eliminate, or at least substantially reduce, the price differential which currently makes arbitrage so attractive." But Sprint mistakenly assumes that enforcement of the Commission's proposed benchmark settlement rates would alone be sufficient to prevent such arbitrage. Sprint fails to recognize that inbound by-pass will remain attractive because of the continuing margin between those rates and the much lower termination costs that are available in the U.S.

apply only to U.S.-inbound services and should not restrict the provision of U.S.-outbound services.[45] Inbound, not outbound, switched services over international private lines provide the ability to by-pass settlements payments to U.S. carriers and to raise prices to U.S. consumers. The Commission should not limit the ability of U.S. carriers to by-pass foreign carriers' high settlement rates on U.S.-outbound calls and reduce costs by taking advantage of any lower termination rates that may be available for private line services in the foreign market.

Unless settlement rates are required to be lowered to cost before inbound switched services may be provided in this way, the Commission should treat these services in a similar manner to that proposed for accounting rate flexibility arrangements. *See* AT&T at 41-43. Under this approach, license applications should be granted only where market conditions at the foreign end of the route are sufficiently competitive to prevent discrimination by a carrier with market power in that country against carriers providing U.S.-outbound switched services over international private lines. Such a showing should require the implementation of WTO commitments to provide market access for switched services over international private lines and the adoption of fair rules of competition as required by the WTO Reference Paper.[46]

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[45] *See also, International Settlement Rates*, File No. IB 96-261, Comments of AT&T (filed Feb. 7, 1997), at 34.

[46] The Commission should also make clear that regulations such as those in existence in Mexico requiring these services to pay the same above-cost settlement rates as IMTS services do not provide sufficient market access. *See* Ministry of Communications and Transport, Mexico, Rules to Render the International Long-Distance Service That Must be Applied by the Concession Holders of Public Telecommunications

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3. Settlement Rate Conditions Are Consistent with WTO Requirements.

Claims that the use of settlement rate conditions for market entry on affiliate routes are contrary to the GATS[47] are also without foundation. First, USTR has previously affirmed -- contrary to foreign carrier claims here and in the *International Settlement Rate Benchmark* proceeding -- that the Commission "can require U.S. licensed carriers to abide by benchmark settlement rates consistent with U.S. MFN and national treatment obligations under the GATS."[48]

Second, the requirement for settlement rates to be established at the high-end of the benchmark range -- or, as AT&T and MCI recommend, at the low-end of the benchmark range -- as a condition of Section 214 authorizations for the provision of switched services over international private lines and U.S.-outbound switched facilities-based and resale services is consistent with these and the other obligations of the GATS. MCI concurs (p. 3) that "such a condition would create a transparent standard consistent with U.S. obligations under the WTO Agreement." The requirement would apply uniformly to carriers from all countries providing service on affiliate routes, including the

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Networks Authorized to Render This Service, Dec. 4, 1996, at Rule 10 (requiring the routing of international traffic "using uniform settlement and proportionate return systems."). A similar approach has now been proposed by Japan. *See* Ministry of Posts and Telecommunications, Japan, Guidelines for the Liberalization of International Private Leased Circuits With Interconnection to the Public Switched Network (Proposal), July 8, 1997, at § 2 (2) (Measures to Secure Fair and Effective Competition).

47 *See, e.g.*, FT at 23; GTE at 21; KDD at 9-12.

48 *International Settlement Rates*, File No. IB 96-261, Reply Comments of the Office of the United States Trade Representative (filed Apr. 10, 1997), at 1.

U.S.[49] Such a requirement is consistent with the MFN and national treatment obligations of Articles II and XVII of the GATS and with the market access required by Article XVI.[50]

Further, as AT&T has described (pp. 14-16), nothing in the WTO agreement prevents the U.S. from imposing conditions on licenses to protect the conditions of competition in its market. The comments filed here by USTR (p. 3) firmly support that conclusion. USTR emphasizes (*id.*) that "the impact the proposed service will have on competition in U.S. markets" is "a critical factor" in the public interest analysis that may be conducted in full conformity with U.S. obligations under the GATS. Just as the denial of license applications posing risks to competition that cannot be addressed by safeguards is consistent with those obligations, so is a requirement for a settlement rate safeguard to reduce those risks also justified under GATS.

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49 The condition should be applied to all further authorizations, including all applications pending on the date of the issuance of the Notice of Rulemaking in the *International Settlement Rate* proceeding. *See id.*, Comments of AT&T (filed Feb. 7, 1997), at 41, n.67. Contrary to the assertion by GTE (p. 21), the condition would not be relevant to U.S. carriers "with control over local 'essential facilities'" but without affiliate routes.

50 Article XVI of the GATS "define[s]" those "measures which a Member shall not maintain or adopt." As a benchmark (or cost-based) settlement rate condition is not covered by any of the prohibited categories of restrictions listed in Article XVI, the claim by Telefonica (pp. 12-13) that such a condition would violate this article is misplaced. There is also no basis to Telefonica's contentions (p. 13) that the condition would breach the GATS Annex on Telecommunications and GATS Article VI. The condition would apply to authorizations to provide service rather than to "access to and use of public telecommunications networks," which is the subject of the Annex on Telecommunications, and Article VI:4 of GATS addresses potential procedural abuses rather than licensing requirements. *See* AT&T at 16 & n.25.

IV. STRENGTHENED POST-ENTRY SAFEGUARDS ARE NECESSARY TO PREVENT THE ABUSE OF FOREIGN MARKET POWER.

The comments by U.S. international carriers confirm that effective post-entry regulation is necessary to protect against anticompetitive conduct by those carriers that have the incentive and the ability to engage in such behavior, with more stringent conditions being applied to carriers not facing competition in the countries in which they have market power.[51] As AT&T has described (pp. 48-49), carriers with market power in countries lacking sufficiently competitive market conditions to limit such misconduct should be subject to additional supplemental dominant carrier rules beyond those proposed by the NPRM. Strict disclosure and separation obligations and an accelerated complaint

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[51] *See* AT&T at 43-53; MCI at 5-8; Sprint at 19-20; WorldCom at 10. The risk of discriminatory conduct by carriers controlling foreign bottlenecks has been underscored by the Commission and by the Department of Justice. See *Sprint Corp.*, 11 FCC Rcd. 1850 (1996); *U.S. v. Sprint Corp. & Joint Venture Co.*, 60 Fed. Reg. 44049 (1995) (Competitive Impact Statement). Both agencies found such conduct to pose a major risk of competitive harm to the U.S. market -- contrary to C&W's blithe dismissal (p. 5) of the potential behavior giving rise to such concerns as being "extremely unlikely to occur." *See Sprint Corp.*, 11 FCC Rcd. at 1860; *Sprint Corp & Joint Venture Co.*, 60 Fed. Reg. at 44063. The suggestions by C&W (*id.*) and DT (p. 22) that there has been no past occurrence of such behavior are also incorrect. FT used its control of bottleneck facilities in France to favor its former U.S. affiliate, TRT/FTC, in the routing of return traffic. *See Sprint Corp.*, File No. ISP-95-002, Opposition of AT&T (filed Nov. 18, 1994), at 34. For several years prior to 1992, FT over-returned France-originated traffic to its U.S. affiliate, while under-returning traffic to other U.S. carriers. *See id.* at 34 & Exhibit D. Nor, contrary to C&W's mistaken belief (p. 5), is it easy to detect or to remedy such misconduct. DT used its control of German bottleneck facilities in 1990 to respond to a perceived competitive threat from AT&T's USADirect service by implementing a proportionate return methodology under which USADirect minutes were counted as DT return minutes, thus raising AT&T's costs by millions of dollars. *See Sprint Corp.*, Opposition of AT&T, at 33-34. As only DT had information concerning its return traffic practices for all U.S. carriers, AT&T was unable to determine the cause of the problem until all

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procedure will be required for BOC local exchange carriers entering competitive, in-region long-distance markets, and there is no showing that these requirements are any less necessary for carriers with market power in closed foreign markets.

Where the foreign market is open to competition, basic dominant carrier rules and "no special concessions" requirements are still necessary for carriers with market power. Those commenters seeking the removal of these requirements for non-monopolists overlook the ability of carriers with market power to engage in discrimination even in the most liberalized markets. Thus, basic dominant carrier rules and "no special concessions" requirements should remain in place (except to the extent they are removed by an approved flexibility arrangement) until the carrier is found to lack market power.[52]

There is no substance to claims by some foreign commenters that dominant carrier rules are not consistent with the WTO agreement. For the reasons already explained, it is quite legitimate to regulate carriers with market power in this way and to take account of foreign market conditions that may affect their ability to engage in anticompetitive behavior.

DT's claim (p. 31) that all dominant carrier rules can be dispensed with once settlement rates are within the benchmark range should also be rejected. Sprint

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U.S. carriers filed their 1990 traffic data with the Commission in July 1991 -- although DT began this conduct in January 1990. *Id.*

52 This may take considerable time as shown by the experience of the UK, where BT retains a 91 percent share of local revenues and 80 percent of long-distance revenues fifteen years after Mercury entered the market and five years after the end of the duopoly. *See U.S. v. MCI Communications, Corp. & BT Forty-Eight Co.*, 62 Fed.

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correctly observes (p. 26) that even the achievement of settlement rates at the low-end of the benchmark ranges will not preclude other types of discriminatory behavior. While cost-based rates would prevent anticompetitive harm in the form of price squeezes and one-way by-pass, they would still allow carriers with market power to raise U.S. carriers' costs and to engage in cross-subsidization. *See* AT&T at 45-46.

Thus, supplemental safeguards should not be removed until the foreign market is sufficiently competitive to limit the ability to discriminate. This requires not only the authorization of multiple international facilities-based competitors, but also the absence of foreign ownership restrictions precluding non-nationals from holding controlling interests in such carriers and the implementation of the WTO Reference Paper.

1. All Carriers with Foreign Market Power Should be Subject to "No Special Concessions" Requirements and Basic Dominant Carrier Rules.

The NPRM correctly proposes (¶¶ 114-118) to limit the "no special concession" requirement to arrangements with foreign carriers with market power and to give greater specificity to that requirement. In fact, the restriction should be set forth with greater clarity, as AT&T has described (p. 46).[53]

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Reg. 37594, 37597 (1997) (Proposed Modified Final Judgment and Memorandum in Support of Modification).

53 The "no special concessions" requirement should preclude acceptance of exclusive arrangements involving any service from carriers with market power in foreign markets affecting traffic or revenue flows to or from the United States. *See* AT&T at 46.

The claim by some commenters that the "no special concessions" restriction is appropriate only for monopoly carriers,[54] ignores the continued ability of incumbents with market power to engage in discriminatory behavior long after the entry of new competitors. Just as not one foreign incumbent carrier, even in the more liberalized markets, has yet reduced its settlement rate to a cost-based level, so these carriers retain the ability to disadvantage U.S. carriers in many other ways through preferential arrangements with other U.S. carriers.[55] The only departure from these requirements should be as required by approved flexible accounting rate arrangements.[56]

The same ability to discriminate requires the imposition of basic dominant carrier safeguards. As AT&T has explained (pp. 47-48), more detailed information should

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[54] *See* BTNA at 5; DT at 28; MCI at 6. DT also contends (p. 28) that it should not be applied to carriers from any WTO Member country -- but its claim is apparently founded on a mistaken belief that all such countries will have "multiple facilities-based international carriers and an effective regulatory regime." *Id.*

[55] Implementation of the all the requirements of the WTO Reference Paper would greatly reduce the possible extent of such discrimination, but would not provide a complete remedy, contrary to the claims by C&W (pp. 4-5) and GTE (p. 10). The Reference Paper does not clearly cover all the exclusive arrangements that are within the scope of the proposed "no special concessions" prohibition (e.g., "arrangements for the joint handling of basic U.S. traffic originating or terminating in third countries" (NPRM, ¶ 117)), and the extent to which U.S. carriers not present in the foreign market would be able to obtain adequate enforcement by foreign regulators is unclear. In any event, to the extent that foreign carriers with market power are already complying with similar requirements imposed by their domestic regulators, no additional burden will be imposed.

[56] The availability of flexibility arrangements and the ability of U.S. carriers to enter into arrangements with non-dominant foreign carriers without being subject to the "no special concessions" requirement shows the unfounded nature of MCI's claim (p. 7) that the effect of applying the restriction to carriers with market rather than monopoly power will be a standardization of all arrangements.

be provided in quarterly revenue and traffic reports on dominant routes, and the existing recordkeeping requirement for the maintaining of provisioning and maintenance records should continue. Rather than the quarterly notification of circuit additions, as proposed by the NPRM (¶ 96), there should be notification of each circuit addition or discontinuation on the dominant route specifying the facilities on which the circuit is added or discontinued.[57]

2. Stronger Supplemental Safeguards Should Apply to Carriers With Market Power in Countries That Are Not Sufficiently Competitive to Prevent Discrimination.

The Commission has rightly proposed (¶ 105) as supplemental safeguards the prohibition of exclusive arrangements with the affiliated foreign carrier for the joint marketing of basic services, the steering of foreign market customers and the use of foreign market customer information.[58] As MCI emphasizes (pp. 7-8), and other U.S.

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[57] Basic dominant carrier rules should also continue to apply where the foreign carrier subject to these requirements enters into a flexible accounting rate arrangement.

[58] SBC (pp. 5-6) wrongly contends that the Commission would be regulating the foreign carrier's use of such information. The Commission would rather be preventing the exclusive use of foreign carrier customer information by the U.S. affiliate, which would be well within its authority. *See* AT&T at 49, n.80. Sprint incorrectly claims (p. 25) that the ability of all U.S. carriers to receive such information from their affiliates should remove this issue as a cause for concern. However, Sprint overlooks that in the non-competitive markets where supplemental safeguards are imposed, the foreign customer information available to the dominant carrier is likely to be far more extensive than any information that may be otherwise available. The Commission properly proposes to prevent the U.S. affiliates of such carriers from benefiting from this advantage.

international carriers concur, more stringent conditions are necessary for carriers with market power in countries where there is no meaningful competition.[59]

C&W objects (pp. 8-9) that joint marketing is frequently necessary for the provision of seamless end-to-end services.[60] But exclusivity is not a necessary feature of such relationships, and exclusive arrangements between a U.S. carrier and its foreign dominant affiliate for the provision of such services provide an unearned and unfair competitive advantage when the foreign carrier enjoys a protected status in its home market.[61] As indicated by Sprint (pp. 22-23), competition will not be fair if the foreign carrier may "discriminate in favor of its affiliate."

Prior approval for the addition of circuits on the dominant route and the filing of quarterly circuit status reports on those routes, including specification of the

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[59] *See also* AT&T at 43-53; Sprint at 19-20; WorldCom at 10.

[60] C&W's dislike (p. 8) for the proposed restrictions on exclusive joint marketing arrangements is not surprising. Some C&W foreign carrier affiliates have market power in countries that have not committed to authorize international facilities-based competitors at any time in the near future. *See, e.g.*, WorldCom at 7-8 (noting that Hong Kong will not open its international market until 2006). C&W's unexplained insistence (p. 9) that exclusive arrangements nonetheless "must exist" if U.S. multinationals are to be provided with seamless services thus rings hollow. As the Commission has found, "consumers of international services do not receive the maximum benefits of reduced rates, increased quality and innovation" where "the benefits of providing international service on an end-to-end basis [] flow solely to a dominant foreign carrier and its U.S. affiliate." *Foreign Carrier Entry Order*, 11 FCC Rcd. at 3880 (emphasis added). Additionally, GTE is incorrect in asserting (pp. 20-21) that joint marketing restrictions are unnecessary in light of the requirement that flexible accounting rate arrangements involving more than 25 percent of the traffic on a route be "not unreasonably discriminatory." Neither the International Settlements Policy nor this safeguard for flexibility arrangements address exclusive joint marketing arrangements for seamless services.

[61] *Id.*

facilities on which circuits are active or idle, should also be required, as the NPRM proposes (¶ 107). These requirements will assist the Commission in remedying anticompetitive behavior by monitoring of the growth and usage of facilities. *Id.* The purpose here is not to duplicate the International Settlements Policy or quarterly traffic reporting rules, as Telefonica would believe (p. 14), but to help detect any evasion of those requirements. For example, as noted by WorldCom (p. 11), the specification of whether circuits are active or idle would allow determination of whether the foreign carrier is "unreasonably denying access to U.S. carriers by claiming a lack of corresponding facilities."

Additional supplemental safeguards are also necessary. First, as AT&T recommends (pp. 50-51), the Commission should go beyond its proposed requirement for the filing of quarterly reports summarizing provisioning and maintenance records concerning facilities and services provided by the affiliated foreign carrier. *See* NPRM, ¶ 108. The Commission's proposal is overly vague concerning the information that should be provided, and would not require such reports with sufficient frequency to allow discrimination to be addressed on a timely basis.

As AT&T has described (p. 50), a requirement for monthly reporting of specific, detailed information concerning affiliate transactions should rather be imposed.[62]

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[62] The U.S. affiliate should be required to file monthly reports showing the prices, terms and conditions of all products and services provided by its affiliated foreign carrier, including copies of all agreements, settlement rates and the methodology for proportionate return, and details of the provisioning and maintenance of all services and facilities provided, including the types of circuits and services provided, the average time intervals between order and delivery, the number of outages and

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Far from adversely impacting competition, as C&W contends (p. 8), both the Commission and the Department of Justice have found the imposition of such reporting requirements necessary to prevent anticompetitive conduct following U.S. market entry by carriers with market power in closed markets.[63] And even greater disclosure is required of affiliate transactions between the BOC local exchange carriers and their interexchange affiliates -- where details of affiliated transactions must be placed on the Internet within 10 days. *See* AT&T at 51.

Structural separation of the U.S. affiliate is also necessary to assist in the identification of cost misallocation and the cross-subsidization of the affiliate from the foreign carrier's non-competitive operations in the foreign market. *See* AT&T at 51-52.[64] As conceded by the Spanish and Latin American monopoly carrier Telefonica (p. 9), a foreign carrier "could use its profits from unrelated activities" to engage in such cross-

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intervals between fault report and service restoration, and, for circuits used to provide international switched services, the average number of circuit equivalents available to the U.S. affiliate and the percentage of 'busy hour' calls that failed to complete. In order to assist such disclosure, the Commission should require all affiliate transactions to be reduced to writing and such records to be kept as part of the affiliate's obligation to maintain records under the basic dominant carrier rules. *See* AT&T at 50.

63 *See Sprint Corp.*, 11 FCC Rcd. at 1873-74; *U.S. v. Sprint Corp. & Joint Venture Co.*, 1996-1 Trade Cas. (CCH) ¶ 71,300 (D.C.D.C. 1996) (Final Judgment), § II.A.5.

64 As AT&T has described (p. 51), the affiliate should be required to operate as a distinct entity with separate officers, directors and employees, to maintain separate accounting systems and records identifying all payments and transfers from the foreign carrier and to receive no subsidy from the foreign carrier or any investment or payment not recorded as an investment in debt or equity.

subsidization, irrespective of its ability to price squeeze through the use of its above-cost settlement rates.

Contrary to the claim by BTNA (p. 4), it would not be sufficient to impose this requirement as a sanction for proven misbehavior. PanAmSat (p. 5) argues that the Commission should require structural separation for the U.S. affiliates of all dominant carriers to prevent discrimination and cross-subsidization and that such a course would be consistent with the Commission's separation requirements for the BOC interexchange affiliates. At a minimum, this key safeguard should be required, as the Department of Justice concluded in *Sprint Corp.*, as a prophylactic measure where the ability of the dominant foreign affiliate to engage in this type of anticompetitive conduct is assisted by a closed home market.[65]

Finally, expedited complaint procedures are also necessary to ensure that anticompetitive conduct by carriers with market power in closed foreign markets may be quickly addressed. *See* AT&T at 52; BTNA at 3-4; MCI at 7.[66]

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[65] *Sprint Corp. & Joint Venture Co.*, 1996-1 Trade Cas., (CCH) ¶ 71,300, § III.F (requiring structural separation pending the opening of the French and German markets). This requirement by the Department of Justice shows the erroneous nature of US West's claim (p. 10) that "accounting safeguards alone" would provide sufficient protection. *See also*, Sprint at 27 ("structural separation makes it less likely that a dominant foreign carrier would be able to discriminate against its other U.S. competitors").

[66] AT&T also recommends (pp. 52-53) that the Commission should facilitate the review of information filed under its dominant carrier rules and pursuant to carrier-specific conditions of approval by requiring all such material to be filed publicly, to be clearly marked as responsive to the relevant filing requirement, and also to be filed with its vendor.

The supplemental post-entry rules are necessary for carriers with foreign market power in countries where multiple international facilities-based competitors have not been authorized, as the NPRM proposes (¶ 104), but also where other competitive conditions do not exist. *See* AT&T at 48-49. The Commission has established in the ECO test, and reaffirms in the NPRM's requirements (¶ 152) for the rebuttal of presumptively lawful flexible arrangements, that fair rules of competition are also necessary to limit discrimination by carriers with market power.[67]

Thus, the supplemental rules should also apply where the country has not implemented the WTO Reference Paper, or where another core requirement of the ECO test, that non-nationals be able to hold controlling interests in competitive international carriers, is not fulfilled. *See* AT&T at 48-49. Otherwise, the Commission will not sufficiently limit the potential for anticompetitive conduct by carriers with the ability and incentive to engage in such behavior.

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[67] The Commission should not be dissuaded from the need to examine the conditions of competition in foreign markets by claims that any such inquiry would be overly burdensome. *See* Sprint at 22. The Commission has considerable experience in conducting such investigations and any burden on the Commission's time and resources would be greatly reduced through adoption of the Commission's proposal (¶ 104) to require the carrier with market power to put forward the necessary evidence to show that supplemental dominant carrier regulation would not be necessary. Moreover, such considerations are insufficient to justify exposing the U.S. market to additional competitive harm.

3. Dominant Carrier Safeguards Are Consistent With WTO Requirements.

Claims that the dominant carrier rules would constitute an improper market access restriction[68] are unfounded, as such regulation is clearly permissible under GATS Article VI for the reasons discussed above in relation to licensing decisions. As USTR emphasizes (p. 3), and contrary to the claims by some foreign commenters,[69] the Commission may legitimately regulate carriers with market power differently from those without market power, and it may also require additional regulation where market conditions in the foreign country would allow a carrier with market power to distort competition. Thus, both the dominant carrier safeguards proposed by the NPRM and the additional safeguards discussed above are consistent with the requirements of the WTO agreement.[70]

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[68] *See* C&W at 9; Telefonica at 14-15.

[69] *See* e.g., DT at 24; EU at ¶¶ 10-11; Japan at ¶ 6; Telefonica at 14. There is also no basis to claims that the GATS national treatment obligation precludes any different regulation of carriers with market power in foreign markets from those with market power in the U.S. domestic market. *See* GTE at 19; Japan at ¶ 6. The Commission traditionally has regulated carriers with market power at the foreign end of an international route differently from those with market power in the U.S. *See* NPRM, ¶ 82 & n.78. The national treatment obligation does not preclude different types of regulation to address different circumstances in this way and requires no more than that U.S. carriers with market power at the foreign end of an international route should not be treated more favorably than foreign carriers with such market power.

[70] Contrary to the claims by FT (pp. 15-16) and Sprint (pp. 34-37), the WTO agreement also does not require the premature removal of the requirements the Commission imposed on Sprint in connection with the equity investments by FT and DT. *See* *Sprint Corp*., 11 FCC Rcd. 1850, 1873-74 (1996). FT incorrectly asserts (p. 16) that the Commission requirements "automatically cease to have any effect once the WTO agreement becomes effective." Sprint is required to comply with these requirements "until further Order by the Commission," *id.* at 1873, and, as described above, the WTO agreement does not prevail over U.S. law. *See* fn. 15, *supra.* Additionally, the

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